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No. 1056

In the Supreme Court of the United States

October Term, 1941.

CHESTNUT SECURITIES COMPANY, A CORPORATION,
Petitioner,
vs.
OKLAHOMA TAX COMMISSION, *Respondent.*

PETITION FOR WRIT OF *CERTIORARI* TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF.

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CHESTNUT SECURITIES COMPANY, A CORPORATION,
Petitioner,
vs.
OKLAHOMA TAX COMMISSION, *Respondent.*

PETITION FOR WRIT OF *CERTIORARI.*

To the Chief Justice and Associate Justices of the Supreme Court of the United States:

Chestnut Securities Company, your petitioner, being aggrieved of a judgment of the United States Circuit Court of Appeals for the Tenth Circuit entered January 16, 1942, in its cause numbered 2289, styled Chestnut Securities Company, appellant, *vs.* Oklahoma Tax Commission, appellee, respectfully petitions review thereof upon the issues of law hereafter stated, praying writ of *certiorari* for the purpose, and as cause and ground therefor respectfully shows:

I.

Statement of Matter Involved.

Petitioner is a Delaware corporation. Respondent is the tax collection agency of the State of Oklahoma.

Petitioner was compelled to pay an Oklahoma tax upon income derived from sources outside the state. This action sought recovery of the tax which was paid under protest. The action is at law, and is expressly authorized by legislative permission of the state. (Title 68, Oklahoma Statutes 1941, Section 1475, Title 68, Oklahoma Statutes Annotated, Section 1475.)

The income in question was the product of large fixed investments in intangible securities which were acquired, held and serviced at all times elsewhere than in Oklahoma. It consisted of interest on notes and bonds, dividends upon corporate stocks, and capital gains realized upon occasional sales of stocks. The tax years in issue were 1936, 1937 and 1938, during which the petitioner held license to do business in Oklahoma.

Nearly all of the subject intangibles were acquired by petitioner in exchange for its original capital stock. They were in no instance acquired as a result of business operations in Oklahoma, nor were they in any instance purchased with the proceeds of Oklahoma transactions. They were acquired in exchange for the original capital stock of the corporation, or were replacements of intangibles so acquired, or were purchased out of the profits or proceeds of intangibles so acquired.

Petitioner's principal corporate objective was and is the acquisition and holding of intangible investments. Petitioner did not broker or deal in stocks, did not purchase or sell them for immediate speculative profits, and did not make marginal purchases or sales at all. Its securities were acquired as fixed investments, and were held for their yield in dividends and interest. Its transactions in securities were limited to infrequent liquidations and replacements dictated by considerations of investment policy. As a secondary pur-

pose and objective petitioner sought and acquired investments in oil properties in the States of Oklahoma and Texas. Its holdings in intangibles represented in excess of ninety per cent (90%) of its whole investment, and its oil properties represented less than ten per cent (10%). Its investment in Oklahoma varied from less than one per cent (1%) to slightly more than two per cent (2%) of its total holdings.

As will subsequently appear, the intangibles were held, handled and disposed of wholly outside Oklahoma, and were never employed in or associated with petitioner's Oklahoma transactions.

Petitioner voluntarily returned to Oklahoma its income derived from oil properties located within the state. It paid the tax attributable thereto. By appropriate proceedings the respondent entered a deficiency assessment whereby the whole of petitioner's income from intangibles was subjected to Oklahoma income tax. The deficiency assessment was protested and petitioner's administrative remedies were exhausted. The amount of the assessment was Six Thousand Three Hundred Seventy-five Dollars Fifty-eight Cents ($6,375.58), which amount is stipulated to be correct if petitioner's intangible income be lawfully subject to the tax. The tax was paid under protest.

Petitioner sued to recover the tax in the District Court of the United States for the Western District of Oklahoma. Jurisdiction was claimed by diversity of citizenship and requisite amount, and also upon the ground that a federal constitutional question was involved. The state consented to the suit by the terms of Section 1475 of Title 68, Oklahoma Statutes 1941.

The trial was to the court without a jury and resulted in a judgment in favor of the respondent Tax Commission. Appeal was taken to the United States Circuit Court of

Appeals for the Tenth Circuit, which affirmed the trial court. This petition is to review the latter judgment.

The preliminary administrative procedure is admitted to be sufficient, and the jurisdiction of the United States Courts has not been questioned.

The original deficiency assessment based respondent's demand on the ground that petitioner, notwithstanding its domicile in Delaware, was a domestic corporation for tax purposes within the terms and meaning of Section 5 (b) of Oklahoma Income Tax Act of 1935 (Appendix to Title 68, Oklahoma Statutes Annotated, Chapter 66, Article 6, Section 5 (b), Oklahoma Session Laws 1935), the pertinent provisions of which are as follows:

> "*(b)* The term 'resident,' as herein used, refers not only to a resident individual, as defined in Section 4 (j) but, in addition, refers to and includes any corporation whose principal business is carried on or transacted in Oklahoma. Such a corporation shall be deemed to be a resident of this state, for income tax purposes, and its income shall be determined, and the tax thereon collected and paid, as if it were incorporated under the laws of Oklahoma, notwithstanding its corporate domicile is elsewhere."

Respondent first contended that petitioner was a "resident" within the foregoing provision, and therefore that its intangibles, wherever located, and the income therefrom, were subject to taxation in Oklahoma.

To this first contention of the respondent petitioner replied:

> *First,* that petitioner was not within the terms of the section quoted, for the reason that its "principal business" was not carried on or transacted in Oklahoma.
>
> *Second,* that the statute invoked contravened the

"due process" and "equal protection" clauses of the Fourteenth Amendment to the Constitution of the United States.

The answer of the respondent to petitioner's suit asserted a second justification of the assessment. It pleaded that petitioner's securities had acquired "business situs" within the State of Oklahoma and therefore that the increment thereof was subject to the state income tax. This contention was proposed as justification of the tax independent of applicability or validity of the statute quoted above.

In reply to this second proposition of the respondent, petitioner urged that definition of "business situs" is a matter of local law, to be determined exclusively by the decisions of the courts of Oklahoma, and that the Supreme Court of Oklahoma had theretofore held these very intangibles of this very petitioner not to have "business situs" in Oklahoma. See *Chestnut Securities Co.* v. *Oklahoma Tax Commission,* 173 Okl. 369, 48 P. (2d) 817.

Thus the legal issues presented to the trial court were three in number:

First, was or was not petitioner's "principal business" carried on in Oklahoma during the years 1936, 1937 and 1938 within the intent and meaning of Section 5 (b) of Oklahoma Income Tax Act of 1935, quoted above?

Second, if the first issue be determined in the affirmative, does the said Section 5 (b) contravene the "due process" and "equal protection" clauses of the Fourteenth Amendment to the Constitution of the United States?

Third, did or did not the intangible investments of petitioner, during the years in question, have "business situs" as defined by the decisions of the Supreme Court of Oklahoma?

All three questions were presented to the trial judge. From his conclusions of law (Tr. 28) it appears that he found the constitutional question unnecessary of decision, and placed his judgment upon a conclusion that the intangibles involved had "business situs" in Oklahoma. In so doing the trial judge ignored the decision of the Supreme Court of Oklahoma in *Chestnut Securities Company* v. *Oklahoma Tax Commission, supra,* and the decision of this court in *Erie Railroad Co.* v. *Tompkins,* 304 U. S. 64, 82 L. ed. 1188.

The Circuit Court of Appeals, while directly affirming the trial court, avoided the "business situs" question. It preferred to pitch its judgment upon the ground that petitioner was within the terms of the statute quoted above and that the statute was constitutional. If its conclusion in this regard be correct the determination of the "business situs" question becomes unnecessary. The appellate court's holding therefore amounts to a finding upon the record that petitioner's "principal business" was transacted in Oklahoma and that the statute defining petitioner to be a resident for tax purposes did not violate the Fourteenth Amendment.

The issues of the case were wholly of law. At the conclusion of the evidence there remained no single issue of fact. The evidence consisted of the testimony of a single witness, which is found at pages 33 to 44 of the transcript. From the admissions of the pleadings and the evidence the following matters appear without dispute.

Petitioner's domicile is Delaware. Its charter objectives are the acquisition and holding of intangible securities and oil properties.

At its charter date, December 22, 1931, petitioner exchanged the whole of its capital stock for large amounts of stocks, bonds, and notes, and a small business building lo-

cated in Tulsa, Oklahoma. The intangibles represented more than ninety per cent (90%) of the gross assets received, and the business building represented less than ten per cent (10%). The intangible securities were thereafter and to this date held for their earnings in interest and dividends. The office building was operated for its rent for one year and was sold in December of 1932. During the years 1933 and 1934 petitioner's assets were wholly intangible. In 1935 petitioner acquired some oil royalties in Texas. The oil investments were added to in the years 1936, 1937 and 1938, by acquisitions in both Texas and Oklahoma.

Petitioner opened two offices at which it transacted its business. They were located respectively at Wilmington, Delaware, and Tulsa, Oklahoma. The Delaware office handled the intangibles. The Tulsa office handled the office building and the oil investments. The two fields of investment were wholly unrelated except that the oil properties were purchased from profits of the intangibles.

The intangible securities were first received by petitioner at its Delaware office. The physical evidences thereof were placd in deposit vaults in Wilmington, Delaware, and Pittsburgh, Pennsylvania, in charge of its employees or agents. They have remained there ever since except as they have been discharged, sold, or replaced by transactions upon the New York markets. Stocks or bonds were invariably delivered and received at the Delaware office or at Pittsburgh, Pennsylvania. Dividends upon the stocks were invariably received and accounted for at the Delaware office. Sales or purchases of intangibles were invariably executed upon the New York exchanges. Accounting entries affecting the intangibles were invariably made at the Delaware office. Proceeds of sales, interest and dividends were invariably received either at Wilmington, Delaware, or Pittsburgh, Pennsylvania, and deposited and held in bank accounts at these

two cities. A third bank account was maintained in St. Louis, Missouri. No stock certificate or bond or note was ever physically present within the borders of the State of Oklahoma. No stock, bond, or note was purchased or acquired in the State of Oklahoma. No such security was ever sold in Oklahoma. No dividend nor sum of principal or interest was ever received or receivable within the State of Oklahoma. No delivery of intangible securities upon either purchase or sale was ever made within Oklahoma. No bank account of petitioner was ever kept in Oklahoma. The intangibles in question were in no instance purchased with proceeds of any Oklahoma operation. Upon the other hand, the purchases of oil properties in Oklahoma were made out of the earnings of petitioner's intangible investments.

Petitioner first qualified to do business in Oklahoma in 1931. This was necessitated by its ownership of the business building at Tulsa. After the sale of the building in December of 1932, its license in Oklahoma was permitted to lapse. During the years 1933, 1934 and 1935 petitioner owned no property of any description in Oklahoma, and was not qualified there. In October of 1936 petitioner purchased a small oil royalty which was located in Oklahoma and again qualified. During the years 1937 and 1938 petitioner acquired other oil investments in the state and maintained its license to do business.

As between petitioner's oil investments and its intangible investments the following division of its physical functions was maintained. Its oil investments in Oklahoma and Texas were supervised from its Tulsa office where petitioner maintained one employee. This office received the proceeds of corporate operations in Oklahoma which consisted entirely of oil and gas sales. The run checks were received at Tulsa, appropriate entry of the receipt was made upon a separate account for each mineral property and the checks

were forwarded direct to Pittsburgh, Pennsylvania, for deposit in the corporate account with Union Trust Company. No other business function was discharged at Tulsa.

All matters relating to the handling of the intangibles and their proceeds were conducted at Wilmington, Delaware, as above set forth. The Delaware office had but one employee as will subsequently appear.

The oil investments and the intangible investments were wholly separated upon the accounting records of petitioner and were wholly separate in employee handling.

The corporation never dealt in intangibles in the sense that the same were bought and sold for immediate profit. Petitioner never sold intangibles as a broker or upon commission. It never underwrote any securities or dealt with the same otherwise than as for income investment. The corporation never speculated in intangibles as that term is commonly understood in connection with purchases or sales upon margin. All transactions of purchase or sale were for full and immediate payment of cash considerations.

The corporate investment in intangibles at all times exceeded ninety per cent (90%) of its total invested assets.

The record will reflect no issue upon any of the foregoing representations of fact. However, the record likewise discloses no issue of fact upon the following circumstances which are less favorable to the contentions of the petitioner.

During the years 1936, 1937 and 1938 all of the stockholders and all of the directors were residents of Oklahoma. All of the officers excepting one assistant secretary were residents of Oklahoma. An assistant secretary resided at Wilmington, Delaware. All directors' meetings were held at Tulsa, Oklahoma. No intangible securities were bought or sold during the years in question except by authorizing resolutions of the directors who met at Tulsa.

All checks drawn upon the corporate bank accounts outside Oklahoma were signed by officers at Tulsa, Oklahoma, and no one had any authority to draw checks upon the said account except officers who were residents of Oklahoma.

The board of directors residing and meeting at Tulsa supervised all of the business of the corporation.

The corporate office at Wilmington, Delaware, was in charge of an assistant secretary who received Twenty-five Dollars ($25.00) per month for the years in question. The assistant secretary was a practicing attorney of Delaware, and the office of the corporation was in the same rooms occupied by the officer as an attorney at law. The corporation did not expend any sum for office rent but the above payment was its total expense for office and services in Delaware. However, the assistant secretary was a direct employee of petitioner and is not an employee or agent of any corporation service company.

Sales of intangibles occurring in 1937 and 1938 were ordered by the directors of petitioner meeting at Tulsa. The sales were executed elsewhere than Oklahoma by employees and agents of the corporation. Profits were realized on these sales.

Thus all trading in intangibles by petitioner with other persons and corporations, and all servicing functions affecting its intangible investments were conducted elsewhere than in Oklahoma. However, all policy making functions, or intra-corporate determinations were discharged by its directors meeting at Tulsa, Oklahoma. In other words, petitioner did its trading in stocks and its accounting and servicing of the same outside the state, but it made up its corporate mind to trade, at Tulsa, Oklahoma.

The trial court and the Circuit Court of Appeals held that the policy making determinations of the board of di-

rectors were "transacting the principal business" of petitioner and that, therefore, it was subject to the provisions of the statute quoted above. It further held the statue consitutional.

II.

Jurisdiction.

The original jurisdiction of the federal courts is founded upon diversity of citizenship and an amount in excess of three thousand dollars involved. The record likewise presents a federal constitutional question in that a state statute, or the application thereof, is charged to violate the terms of the Fourteenth Amendment to the Constitution of the United States.

Jurisdiction of this court to review the judgment of the Circuit Court of Appeals is claimed under the provisions of Subsection (a) of Section 347 of Title 28, United States Code Annotated, being Section 240 of the Judicial Code as amended. The review is sought by writ of *certiorari.*

The statute of Oklahoma, the validity of which is involved, is Section 5 (b) of Oklahoma Income Tax Act of 1935, published in Appendix to Title 68, Oklahoma Statutes Annotated, and being Chapter 66, Article 6, Section 5 (b), Session Laws of Oklahoma 1935, which is in terms as set forth, *supra,* page 4.

The applicability of the above statute to petitioner, and the constitutional validity of the statute, if applicable, were placed directly in issue by the pleadings; by a motion for judgment upon the pleadings and undisputed evidence, duly excepted to; and were raised in the Circuit Court of Appeals by specification as required by the Rules of Civil Procedure. Both questions were decided directly and adversely to the petitioner by the Circuit Court of Appeals.

The judgment of the Circuit Court of Appeals, which this petitioner seeks to review, was entered upon January 16, 1942. This petition will be presented to this court upon March 19, 1942.

Copy of the opinion of the Circuit Court of Appeals is found in the transcript beginning at page 48.

III.

Questions Presented.

The review prayed for by this petition will present the following questions:

(1) During the years 1936, 1937 and 1938, did or did not petitioner transact its "principal business" in Oklahoma within the intent and meaning of Section 5 (b) of Oklahoma Income Tax Law of 1935?

(2) In connection with decision of the first question stated above, did or did not the Circuit Court of Appeals transgress the rule announced in *Erie Railroad Co.* v. *Tompkins,* 304 U. S. 53, 82 L. ed. 1188, by ignoring the implications of the decision of the Supreme Court of Oklahoma in *Chestnut Securities Co.* v. *Oklahoma Tax Commission,* 173 Okl. 369, 48 P. (2d) 817?

(3) Does or does not Section 5 (b) of Oklahoma Income Tax Law of 1935, being Chapter 66, Article 6, Section 5 (b), Session Laws of Oklahoma 1935, infringe the "due process" and "equal protection" clauses of the Fourteenth Amendment to the Constitution of the United States?

(4) In the event that one or another of the above questions be decided favorably to petitioner, there will be presented the additional question of whether or not petitioner's intangibles had such "business situs" in Oklahoma as to render the income therefrom taxable independent of the validity or appli-

cability of the statute cited. Upon this issue petitioner will again invoke the rule of *Erie Railroad Company* v. *Tompkins, supra,* in favor of the decision of the Supreme Court of Oklahoma in the case of *Chestnut Securities Company* v. *Oklahoma Tax Commission, supra.*

IV.

Reasons for Allowance of the Writ.

Petitioner, as reasons for the allowance of the writ of *certiorari* prayed for, proposes the following:

(1) The Circuit Court of Appeals has decided an important question of local law erroneously and in a way probably in conflict with the applicable local decisions. We refer to the construction given Section 5 (b), Oklahoma Income Tax Law of 1935, *supra,* by the Circuit Court of Appeals in the face of the decision of the Supreme Court of Oklahoma in *Chestnut Securities Co.* v. *Oklahoma Tax Commission, supra,* which is fully discussed in the appended brief.

(2) The Circuit Court of Appeals has decided a question of federal constitutional law in a way probably in conflict with the applicable decisions of this court; and certainly in conflict with the decision of the Supreme Court of Wisconsin in the case of *Newport Co.* v. *Wisconsin Tax Commission,* 219 Wis. 283, 261 N. W. 884, which is identical in point of fact and law, and which this court declined to review upon petition for *certiorari,* 297 U. S. 720.

Wherefore petitioner prays that writ of *certiorari* shall issue addressed to the United States Circuit Court of Appeals for the Tenth Circuit, commanding said court to certify and send to this Court for review and determination a full and complete transcript of the record and all of its pro-

ceedings in the certain cause numbered 2289 upon its dockets, entitled *Chestnut Securities Company, a corporation, appellant,* v. *Oklahoma Tax Commission, appellee,* and that upon such writ and review the judgment of the said United States Circuit Court of Appeals for the Tenth Circuit, made and entered upon January 16, 1942 in the cause designated above, shall be reversed, and that the judgment of the trial court affirmed thereby shall likewise be reversed and set aside with directions to enter judgment in favor of this petitioner for the reliefs and sums first sued for.

Petitioner further prays that it shall have such other and further relief in the premises to which this court shall find it duly entitled.

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